S. HRG. 109–59

EXPLORING THE ECONOMICS OF RETIREMENT

HEARING

BEFORE THE

SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

WASHINGTON, DC

MARCH 15, 2005

Serial No. 109–4

Printed for the use of the Special Committee on Aging

U.S. GOVERNMENT PRINTING OFFICE

21–037 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

SPECIAL COMMITTEE ON AGING

GORDON SMITH, Oregon, *Chairman*

CONTENTS

EXPLORING THE ECONOMICS OF RETIREMENT

TUESDAY, MARCH 15, 2005

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room SD–562, Dirksen Senate Office Building, Hon. Gordon H. Smith (chairman of the committee) presiding.

Present: Senators Smith, Collins, Talent, Craig, Burns, Kohl, Wyden, Lincoln, Bayh, Carper, Clinton, and Jeffords.

OPENING STATEMENT OF SENATOR GORDON H. SMITH, CHAIRMAN

The CHAIRMAN. Good morning, ladies and gentlemen. We will convene this hearing of the Senate Special Committee on Aging. I know a number of our colleagues are en route, but in respect of Chairman Greenspan's time, we are going to try and conduct this hearing within a 2½ hour period or shorter, if possible.

I know Senator Kohl has joined us and we welcome him as well. We are just barely starting, Senator.

We are fortunate to have Federal Reserve Board Chairman Alan Greenspan here with us to help us explore the economics of retirement. He has given these matters a great deal of thought as well as having the ability to share with us his experience in chairing the bipartisan Social Security panel that helped forge the last rescue of the program in 1983.

As the witnesses in our hearing last month clearly articulated, with the onslaught of baby boom retirees in the coming decades, the expenditures of Social Security, Medicare, Medicaid, and other public and private pension programs will rise rapidly in the coming year. However, with the large exodus of older workers from the labor force, the pool of working-age Americans will rise only modestly, potentially depriving our nation of what has been one of its major engines of economic growth. Balancing the income and outgo of the Social Security system may now be our principle focus, but as we will hear today, a primary goal of any legislation should be to increase national savings and stimulate the increased productivity needed to achieve higher economic output.

Meeting the promises made to future retirees depends more on the size of the economy than whether claims on future resources are built into public or private retirement programs. Raising future taxes for Social Security or accumulating stocks and bonds in new personal accounts will mean little if the economy has not expanded

sufficiently to match the consumption needs of an older nation. It is the economy's capacity to grow over the next few decades that offers the greatest security to our aging population.

Much of the recent debate considers Social Security in isolation from the rest of the government, the economy, and other means by which people strive for retirement security. If balancing the system's, income and outgo were all that mattered, the simplest fix would be to pass a law adding more government bonds to the Social Security trust funds. However, there is no excess money in the general fund, and because Federal deficits are projected for as far as the eye can see, none is expected in the future. That means there are two recourses in the future for making good on those bonds: Raising taxes or borrowing. Neither of those actions will increase the size of the economy, and in all likelihood, they would impair it.

Economic growth will not occur without sacrifices. People can do two things with their money. They can buy things that they consume immediately or they can invest their money to enable them to consume in the future. Simply put, there is no free lunch in achieving national savings. As we will hear today, the same is true when making government policy.

So before we proceed to Chairman Greenspan, it is my pleasure to turn the microphone to my colleague, the Ranking Member, Senator Herb Kohl, who has remarks of his own to make.

OPENING STATEMENT OF SENATOR HERB KOHL

Senator KOHL. I thank you, Mr. Chairman, and we thank you, Chairman Greenspan, for your appearance here today.

Chairman Greenspan, back in the 1980's, you served as chairman of a commission to strengthen Social Security at a time when Social Security could only pay full benefits through the middle of 1983. Now, that was a real crisis, and such is not the case today. Social Security can pay full benefits for another 40 to 50 years, and after that, even if nothing is done, as you know, Social Security could still pay 70 to 80 percent of its promised benefits. So what we are dealing with here today is nothing close to a complete bankruptcy of the program.

Of course, we do not believe that nothing should be done, but it is clear that for those of us who are truly interested in strengthening Social Security—and not dismantling it or replacing it with something very different—the problem can be fixed through relatively modest adjustments. But instead, the President has proposed changing Social Security to a new, untested, and very expensive system of private accounts.

Mr. Chairman, as you have said, private accounts will do nothing to improve Social Security's solvency, and they would not meet your goal, which I share, of increasing national saving. On the contrary, they would add up to $5 trillion to our national debt. So you can see why many of us are skeptical. If we truly want to increase saving, our priority should be reducing the Federal budget deficit, which you have said is the best way to increase national saving.

That is what bothers many of us here about this debate. It sidetracks us from the central issue that we should be discussing: that our country faces growing budget deficits that will take their

toll not just on our ability to sustain programs like Social Security, but also on other important programs, like Medicare.

Medicare, like Social Security, faces a future in which more and more seniors will be eligible for the program with fewer and fewer workers paying taxes to support them; but unlike Social Security, the dollar value of Medicare benefits is not set by a formula. It is dependent instead on the skyrocketing costs of health care. Every estimate shows Medicare's share of the Federal budget increasing at a far greater rate than Social Security's. The President has focused only on Social Security, but I know you agree that we need to think about all other programs that will put a strain on the budget in the coming years.

It is clear that the biggest problem is not Social Security. In fact, GAO estimates that Social Security accounts for less than 10 percent of the government's long-term future liabilities. If we are serious about dealing with all of our fiscal challenges, then we should be spending our time and effort looking at the entire Federal budget. That includes the budget and tax policies that this Administration has chosen.

The President talks about fiscal restraint; however, CBO estimates that the Administration's budget policies would increase the budget deficit by $1.6 trillion over the next 10 years. The cost of making the tax cuts permanent would be $11 trillion over 75 years, which is three times the cost of fixing Social Security. The cost of repealing the estate tax entirely would be almost 25 percent of the cost of fixing Social Security.

What we really face here are choices, and supporters of private accounts and tax cuts have made their choice. I believe it reveals that they are not serious enough about dealing with our budget deficit or increasing national saving, and it calls into question whether they are interested in strengthening the long-term solvency of Social Security.

But we can choose differently. The American people expect us to have a serious debate and come together to solve the challenges facing Social Security. Unfortunately, the debate today has become, as you know, so polarized that partisan sniping and deadlock are the most likely outcomes. That is unacceptable. Americans expect a more serious effort when it comes to a program as important as Social Security. In 1983, as you know, people from both sides came together under your direction and were able to strengthen Social Security for another 75 years, but this model has not been followed by this President. He has not bothered to consult very much, if at all, with Democrats, nor has he formed a truly bipartisan commission, which is what the American people want and deserve, and which was done in 1983 under President Reagan.

Everyone knows that you cannot achieve lasting change to this highly popular program, or tackle the tough fiscal issues we face across the board, without broad bipartisan support and participation. Therefore, the goal should be real bipartisanship, and not just trying to pick off a few Democrats as bipartisan window dressing. Only then will we be able to strengthen Social Security, which has protected millions from poverty and provided a sense of security to all Americans.

We thank you for being here, and, Mr. Chairman, I turn it back to you.

The CHAIRMAN. Thank you, Senator Kohl.

If there is no objection, I would propose that each member have an opportunity for a brief opening statement on the basis of their time of arrival. So we will turn first to Senator Wyden and then Senator Craig.

OPENING STATEMENT OF SENATOR RON WYDEN

Senator WYDEN. Thank you, Mr. Chairman. I commend you, Mr. Chairman, and Senator Kohl, and I will be brief.

Chairman Greenspan, I don't see how you can explore the economics of retirement, the topic of today's hearing, without digging into the question of the weakening dollar. The weakening dollar is particularly hard on older people. Suffice it to say right now, we are talking about how we persuade people to save more in America, and I think it is pretty stunning when you lock at Newsweek Magazine this week, they say in an article that Americans should consider savings accounts and certificates of deposit in foreign currencies. They make this argument on the basis of the weakening dollar. So I intend to explore with you this morning this question of the weakening dollar and how far we are really going to let this slip. That will be the first area that I look at.

The second that leaves me puzzled is why you give short-shrift to the issue of health care. Health care in your statement today gets one sentence and a footnote. As far as I can tell, you essentially say nobody really understands the ramifications of health care technology, so we really cannot get into this now. I would respectfully disagree. Senator Hatch and I have authored a bipartisan law that is now being implemented that is going to look at some of the tradeoffs necessary to address this health care issue, and I want to explore that with you this morning, because like my view with respect to the weakening dollar, I just don't think this country can duck this issue of health care any longer, and that is the point of the bipartisan law that I have authored with Senator Hatch.

So, as always, we welcome you and look forward to discussing these important issues, and especially to my friend from Oregon, Senator Smith, I thank him for scheduling this.

The CHAIRMAN. Thank you, Senator Wyden.

Senator Craig.

OPENING STATEMENT OF SENATOR LARRY CRAIG

Senator CRAIG. Mr. Chairman, thank you very much.

Chairman Greenspan, welcome again before the Aging Committee.

I had the opportunity about a year and a half ago to explore with you the dynamics of the Social Security system juxtaposed to Medicare and prescription drug reform, and I remember at that time, and, Ron, it may assist you a little bit in why the chairman is saying what he is saying today. I remember asking you the question which is the easier of the two to fix, and I have used your comments since that time, because I thought they were very profound. In essence, you say said Social Security is by far the easier to fix because we know the numbers. We can adjust accordingly. We can determine cash-flow. It is a relatively fixed model.

Health care is dynamic, constantly changing and constantly improving and very expensive, and how do with we fit that into a model and be able to predict accurately the outcome and the cost? I mean, I am paraphrasing you, Mr. Chairman. I would certainly not put words in your mouth, but generally that is what I gained from your comment.

I am probably one of the few on this panel besides possibly Senator Jeffords who was in the Congress in 1980, 1981, 1982, and 1983, and I must tell you, Senator Kohl, I was there for the wrestling match between the two Irishmen, Tip O'Neill and Ronald Reagan on the issue of Social Security reform. I will tell you who won the wrestling match in the first go around. The Democrats did. The reason they did was because Claude Pepper and company went out to the land and said Republicans are going to destroy the Social Security system and only Democrats can save it, and that resulted in the unelection of a variety of my colleagues that were in the class of 1980. Republicans saw in part the reality of the politics of the issue of that time, and Ronald Reagan, wise man that he was, along with Tip O'Neill agreed to put together a group that you chaired.

The reform, and you will again correct me if I am wrong, was not unlike the model we had used in the past for Social Security. It was a relatively simple model. It is, in fact, a model that many are asking for today. How do you fix it? You simply raise taxes and cut benefits, raise taxes and cut benefits, raise taxes and cut benefits.

I have a granddaughter who is 7 years old. I have done the numbers for her. If we raise taxes and cut benefits, my guess is that my granddaughter when she hits 22 or 23 is going to be paying around 18 percent of her gross so that grand-daddy can live well. I am phenomenally fearful not for the this grand-daddy, but for a lot of the grand-daddies out there that might be told by their grandchildren in the future, you know, you are too darned expensive for us anymore; we simply can't afford to put our kids in college, buy our homes, buy our cars, and pay for your retirement, Social Security/supplemental income because it is taking too big a chunk of our hard earned pay.

Now, that juxtaposed against the demographics and the work force out there and all of that kind of thing, Chairman Greenspan and I while I chaired this committee did something else. We looked at the demographics of aging. We looked at the dynamics of a coun-

try growing older than younger and a diminishing work force against technology and therefore fewer paying into the system, and I must say our President is very wise to challenge us to think beyond the traditional box of reforming Social Security, of raising taxes, cutting benefits, raising taxes, cutting benefits.

I don't mind less benefits, but I do worry greatly about my concern that my grandchildren are going to be asked to pay a prohibitive tax against a program in which they will receive very little in return compared to what my parents, their great grandparents, and I will receive. It is a challenge for us all of us. It is not something to be demagogued. In the past it has been. Two wish Irishmen finally came together, formed a study group, came out with a change, but I do remember a change that I believe I voted for, and it was the largest tax increase on the working men and women of this country ever perpetrated by Congress. Did it fix and sustain Social Security in the out years? You bet it did, and it will for those who are in the system now and receiving, but the work force of America pays more and in general the retiree gets less. That, in my opinion, is not necessarily a good model.

But I do thank you for being here today. It is a phenomenal challenge for us that I hope we can stand together on as we have in the past.

Thank you Mr. Chairman.

The CHAIRMAN. Thank you, and by order of arrival, we will next go to Senator Talent, Senator Collins, Senator Jeffords, and Senator Bayh.

OPENING STATEMENT OF SENATOR JAMES TALENT

Senator TALENT. Mr. Chairman, I came primarily to hear Chairman Greenspan. I appreciated Senator Craig's comments, and I know you want the hearing to be about more than Social Security. I have some questions prepared, for example, with regard to health care, what we might be able to gain for the system if we can recall fully implement information technology in health care as we have in other sectors of the economy, and the potential productivity gains I think are huge, and if I can be here when it is my turn to ask questions, Mr. Chairman, I will do that.

But I do want to echo Senator Craig's comments that, we have heard so much about investments. The nature of finances and personal finances has changed so much in the last generation, I would hope that we could look at whether we can use some of those gains and some of what we have learned to help us to protect Social Security for the future without having to face the Hobson's choice that Senator Craig mentioned of another big tax increase or big benefit cut, and I hope we can all get together and try to do that.

I am going to reserve the rest of my opening statement, Mr. Chairman, maybe make a comment or two when it is my turn to ask questions.

Thank you.

The CHAIRMAN. Thank you, Senator Talent.

Senator Collins.

OPENING STATEMENT OF SENATOR SUSAN COLLINS

Senator COLLINS. Thank you, Mr. Chairman, and thank you for calling this very important hearing.

I want to begin my comments today by thanking our distinguished witness for his public service. He has made so many sacrifices over the years in order to serve the American people, and I want to thank him for his extraordinary public service and also for giving us the benefit of his wisdom today.

Senator Craig mentioned that he was in Congress back in the early 1980's when what was known as the Greenspan Commission did the fundamental recommendations on reforming and saving Social Security. Well, I was not in public office at that time, but I was a Senate staffer at that time, working for Senator Bill Cohen. So remember that well. I was going to describe myself as a young Senate staffer at that time when I realized how many years ago, indeed, it was. But that commission was able to produce bipartisan recommendations really non-partisan recommendations, is a tribute to the leadership of our witness today, and it makes me wonder whether that is a model for our proceeding to face the very big challenges that we see today.

Social Security has been a huge success. It is our nation's largest and most poplar government program. More than 47 million Americans rely on Social Security, and for two-thirds of them, it is their major source of income. I think as we look at how to preserve and modernize the system, we always need to remember that for many Americans, Social Security is the safety net that makes the difference between poverty and an adequate standard of living during their retirement years.

We also should remember that Social Security is not just a retirement program. It is also a disability insurance program and a life insurance program that provides families of active workers with protection worth more than $12 trillion. That is more than all the private life insurance currently in force.

Unfortunately, as successful as Social Security has been, we know that the system faces serious long-term financing problems and is simply not sustainable in its current form. While the system is sound today, it will not be able to meet its obligations to future retirees unless it is modernized.

Our Social Security cash surplus begins to decline in 2008. That is just three years from now. Generally when you have heard discussion about Social Security, the focus has been on either 2018 or 2042, but, in fact, in just three years, the cash surplus begins to decline, and that is because that is when the first of the baby boomers reaches age 62, the earliest age at which Social Security benefits can be drawn and the age at which about half of those eligible to claim benefits have done so in recent years.

In recent weeks, there has been a lot of debate about whether Social Security is facing, quote, a crisis or just facing, quote, serious problems. Whether the system is facing a crisis or serious problems is really just a matter of semantics, and I think it is a disservice for the American people for us to be spending time in the Senate debating whether or not this reaches the level of a crisis when clearly all the projections show that Social Security is not sustainable in the long run for our children and our grandchildren,

and that is why I believe that we should start dealing with Social Security's financing problems, because then the solution will be less disruptive.

But given the universal importance of this program, it is absolutely critical that we get this right. Any changes that are implemented must be carefully thought out, thoroughly understood, and have solid basis of bipartisan support that cuts across all age and income groups. As I look at the various proposals for Social Security reform, I want to make certain that we preserve and, indeed, strengthen that safety net. I think we should look, for example, at increasing the minimum benefit and having a guaranteed benefit, because the principle that we ought to endorse is that if you work your whole life, you should not retire in poverty. That means looking at the adequacy of the minimum benefit as well as securing the solvency of the system.

So, Mr. Chairman, thank you again. This is an extraordinary important hearing, and I appreciate your leadership.

The CHAIRMAN. Thank you, Senator Collins.

Senator Jeffords.

Senator JEFFORDS. I will pass.

The CHAIRMAN. Senator Bayh.

OPENING STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. Thank you, Chairman Smith.

Chairman Greenspan, welcome.

From our time together on the Banking Committee, you know it is my practice to forego opening statements. I regret that the problem in Congress arises today that I am expected to be in simultaneous places or several places simultaneously. So I am going to make just a couple of opening comments today, and I hope you will bear with me.

I was struck by something that Senator Craig mentioned, and I want to agree with him about the need for bipartisanship and for neither side to demagogue these important issues. Senator, I was particularly struck by your concern for your grandchildren. It is something I think about with regard to my own young sons, and I think is fundamentally immoral of us to pass on our obligations to future generations when we should be meeting them ourselves. This is particularly so when we are increasingly in debt to foreign nations, and I hate to think of our children or your grandchildren someday paying with interest our obligations to other countries.

They also will be paying not only for imbalances in the Social Security system, however, but for the underlying Federal budget deficit, which if you look to the out years may, in fact, equal or exceed the liabilities in the Social Security system. So to this Senator's way of thinking, if we are going to really get to a bipartisan consensus on doing right by our children and grandchildren, we need to address both Social Security and the budget deficit so that they won't be forced to meet our obligations.

This raises in my mind, Mr. Chairman, a conundrum that I posed the last time we were before the Banking Committee, which is how we simultaneously argue that Social Security is in crisis—that is not a word that you have used, but there is an actuarial

problem there that needs to be addressed—but at the same time, we are some flush with cash that we can afford further tax cuts.

This is a situation which needs some explanation, and so I would suggest to my colleagues that if we really are going to address the long-term fiscal solvency of our country, both sides need to not demagogue these issues, but try and address the underlying problems in a way that will do right by future generations.

Mr. Chairman, if I have to leave before my question time, here were the three that I would have posed to you. So perhaps if you can address them at some point in your comments or maybe your able staff could get back to me, that would be wonderful.

There has been some research about increasing private savings that is noticed that in traditional 401(K) and private savings plans, when the approach that we take today is followed with the asking employees whether they wish to opt into these savings programs, the participation rate is somewhere between 25 and 43 percent. If instead we shift the presumption and require employees to opt out of those savings programs, the experience seems to be that participation rates increase up to 80 or 90 percent. So my question to you is would changing that presumption be a good thing? If so, it then creates what I refer to is as a problem of success, and that is that some of the business communities say, "Well, if we are going to have increasing participation in these plans, well, then we are going to have to provide the match and that increases our costs, and some in the private sector are resistant to doing that." So is it a good idea, and if so, how do we address the concerns that some in the private sector would express as a result of the success of increased private savings through that vehicle?

My second question relates to the estimates that the Social Security system, the trustees have made about their long-term projections for both growth and productivity over the next 30 or 40 years. I believe they estimate economic growth on average at 1.9 percent and productive rates of growth at 1.6 percent, which based upon our recent experience seems to me to be rather modest, both of these estimates, which raises another conundrum. If the estimates are, in fact, somewhat low, does not that mean that the Social Security imbalance is somewhat less than we are currently estimating.

Conversely, if the estimates are correct, and, in fact. economic growth is projected to be at 1.9 percent for the foreseeable future, does that not mean that market rates of return on investments might correspondingly be somewhat low if the economy is only growing at that rate of return? How do we square? So are those estimates accurate? If not, how do we square those to outcomes if they are not?

Finally, I have seen in your submitted testimony that you raise the issue of the unified budget and the false sense of security that gives to people on our side of the dias here today when it comes to our assessment of the fiscal situation of the country and the lamentable situation we have got in actually using Social Security revenues for other things. Would it be good in your opinion if we abandoned the unified budget and, in fact, segregated Social Security funds for the purposes of putting together the Federal budget?

Those are my questions, Mr. Chairman, and I thank you for your presence.

Chairman Smith, I thank you for calling the hearing today.

The CHAIRMAN. Thank you, Senator Bayh, and we have been joined by Senator Lincoln, Senator Burns and Senator Clinton.

Senator Lincoln, you are next.

OPENING STATEMENT OF SENATOR BLANCHE LINCOLN

Senator LINCOLN. Thank you, Mr. Chairman. I will submit my statement for the record, will welcome Chairman Greenspan to the committee, and look forward to being able to have a discussion and ask some questions on what I believe not just Social Security to be a problem in terms of retirement, but the fact that we are exploring the economics of retirement. I hope that we will also talk about the other pieces of the puzzle that exist in that, which would be Medicare, Medicaid, a lot of the other components that really do have an impact on retirement.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Lincoln.

Senator Burns.

OPENING STATEMENT OF SENATOR CONRAD BURNS

Senator BURNS. Thank you, Mr. Chairman.

I have not served on this committee for a while, and I am back under a new chairman. Chairman Smith, we welcome you and under your leadership, and, Chairman Greenspan, it is nice to see you again.

I have no opening statement, although we have some concerns, and I will submit the questions and I would imagine, probably, that everybody will have just about the same question. The problem arises in time that not everybody gets to ask theirs. So I shall listen very closely. I know there are changes in the winds that we have a system that is in the sustainable, and I think it is incumbent on us to work on the reforms that will make it that way, taking advantage of a lot of circumstances that we have in this country.

So I thank the leadership, and I have no opening statement.

Mr. Greenspan, welcome to the committee.

The CHAIRMAN. Senator Clinton.

OPENING STATEMENT OF SENATOR HILLARY CLINTON

Senator CLINTON. Thank you very much, Mr. Chairman. I thank the ranking member, both of you for the hearings you have been holding in this committee which are addressing some very important issues, and of course I appreciate your having Mr. Greenspan here for us to ask questions. I do not have an opening statement. I just will wait and hear the questions myself.

The CHAIRMAN. Chairman Greenspan, thank you for your patience in listening to all of us. I think in my eight years in the U.S. Senate, I do not know of any single individual who has been more quoted by both sides of the aisle than you, sir, and I join the comments of several here to say how much we honor your service to Presidents, both Republican and Democrat and how much your counsel is listened to here. I think you know that because we quote

you equally on both sides. We appreciate your time and especially appreciate the gravity of this most important topic, which is the retirement of America.

So, sir, the microphone and the time is yours.

STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN, FEDERAL RESERVE BOARD

Mr. GREENSPAN. Thank you very much.

Mr. Chairman, Senator Kohl, and members of the committee, I am particularly pleased to be here today to discuss the issues of population aging and retirement. In so doing, I would like to emphasize that the views I will express are my own and do not necessarily represent those of the Federal Reserve Board.

The economics of retirement are straightforward: Enough resources must be set aside over a lifetime of work to fund consumption during retirement. At the most rudimentary level, one could envision households actually storing goods purchased during their working years for use during retirement. Even better, the resources that would have otherwise gone into producing the stored goods could be diverted to the production of new capital assets, which would produce an even greater quantity of goods and services for later use. In the latter case, we would be raising output per worker, our traditional measure of productivity, including, of course the supplementary measure of output per hour.

The bottom line in the success of all retirement programs is the availability of real resources at retirement. The financial systems associated with retirement plans facilitate the allocation of resources that supply retirement consumption of goods and services; they do not produce goods and services. A useful test of a retirement system for a society is whether it sets up realistic expectations as to the future availability of real resources and, hence, the capacity to deliver post-work consumption without overly burdening the standard of living of the working-age population.

In 2008, the leading edge of what must surely be the largest shift from work to retirement in our nation's history will become evident as some baby boomers become eligible for Social Security. According to the intermediate projections of the Social Security trustees, the population 65 years of age and older will be approximately 26 percent of the adult population in 2030, compared with 17 percent today. This huge change in the structure of our population will expose all our financial retirement systems to severe stress and will require adjustments for which there are no historical precedents. Indeed, retirement, generally, is a relatively new phenomenon in human history. Average American life expectancy a century ago, for example, was only 47 years. Relatively few of our citizens were able to enjoy many post-work years.

One consequence of the sizable baby boom cohort moving from the work force to retirement is an inevitable slowing in the growth of gross domestic product per capita relative to the growth of output per worker. As the ratio of workers to population declines, so too must the ratio of output to population, assuming no change in the growth of productivity. That result is simply a matter of arithmetic. The important economic implications of that arithmetic is that with fewer workers relative to dependents, each worker's out-

put will have to support a greater number of people. Under the intermediate population projections of the Social Security trustees, for example, the ratio of workers to the total population will shrink about 7 percent by 2030. This shrinkage means that by 2030, total output per person will be 7 percent lower than it would be if the current population structure were to persist. The fact that a greater share of the dependents will be elderly rather than children will put an additional burden on society's resources, as the elderly consume a relatively large share of the per capita resources, whereas children consume relatively little.

This inevitable drop in the growth rate of per capita GDP relative to the growth of productivity could be cushioned by an increase in the labor force participation, which would boost the ratio of workers to population. Increasing labor force participation seems to be a natural response to population aging as Americans not only are living longer, but are also generally living healthier. Rates of disability for the elderly have been declining, reflecting both improvements in health and changes in technology that accommodate the physical impairments that are associated with aging. In addition, work is becoming less physically strenuous and more demanding intellectually, continuing a century-long trend toward a more conceptual and less physical economic output.

Despite the improving feasibility of work at older ages, Americans have been retiring at younger and younger ages. For example, in 1940, the median age of retirement for men was 69; today, the median age is about 62. In recent years, labor force participation among older Americans has picked up somewhat, but it is far too early to determine the underlying causes of this increase. Rising pressures on retirement incomes and a growing scarcity of experienced labor could induce further increases in the labor force participation of the elderly and near-elderly in the future. In addition, policies that specifically encourage greater labor force participation would also lessen the necessary adjustments to consumption. Workers nearing retirement have accumulated many years of valuable experience. So extending labor force participation by just a few years could have a sizable impact on economic output.

Another way to boost future standards of living is to increase saving. We need the additional saving in the decades ahead if we are to finance the construction of a capital stock that will produce the additional real resources needed to redeem the retirement claims of baby boomers without having to severely raise the claims on tomorrow's workers.

However, by almost any measure, the required amount of saving that would be necessary is sufficiently large to raise serious questions about whether we will be able to meet the retirement commitments already made. Much has been made of shortfalls in our private defined-benefit plans, but the gross underfunding currently at $450 billion, although significant as a percentage of the $1.8 trillion in assets of private defined-benefit plans, is modest compared with the underfunding of our publicly administered pensions.

At present, the Social Security trustees estimate the unfunded liability over the indefinite future to be $10.4 trillion. The shortfall in Medicare is calculated at several multiples of the one in Social Security. These numbers suggest that either very large tax in-

creases will be required to meet the shortfalls or benefits will have to be pared back.

Because benefit cuts will almost surely be at least part of the resolution, it is incumbent on government to convey to future retirees that the real resources currently promised to be available on retirement will not be fully forthcoming. We owe future retirees as much time as possible to adjust their plans for work, saving, and retirement spending. They need to ensure that their personal resources, along with what they expect to receive from government, will be sufficient to meet their retirement goals.

Conventional advice from personal-finance professionals is that one should aim to accumulate sufficient resources to provide an overall replacement rate of about 70 percent to 80 percent in retirement. Under current law, Social Security promises a replacement rate of about 42 percent for workers who earn the economy wide-average each and every year through their careers and about 56 percent for low-wage workers who earn 45 percent of the economy wide-average. Assuming that taxes are capped at the current 12.4 percent of payroll, revenues will be sufficient to pay only about 70 percent of current-law benefits by the middle of this century. Thus, for the average worker, a replacement rate of only about 30 percent would be payable out of contemporaneous revenues, assuming that benefit reductions are applied proportionally across the board. For a low-wage worker, the payable replacement rate would be about 40 percent. Assuming that the goal is still to replace 70 percent to 80 percent of pre-retirement income, average workers by the middle of this century should be aiming to replace about 45 percent of their pre-retirement income, rather than today's 33 percent, out of some combination of private employer pension benefits and personal saving.

The required increases in private savings would be less to the extent that Social Security tax increases are part of the solution. However, to avoid any changes in replacement rates, the Social Security tax rate would have to be increased from the current 12.4 percent to about 18 percent at the middle of the century.

Once we have determined the level of benefits that we can reasonably promise, we must ensure that we will have the real resources in the future to fulfill those promises. When we evaluate our ability to meet those promises, focusing solely on the solvency of the financial plan is, in my judgment, a mistake. Focusing on solvency within the Social Security system, without regard to the broader macroeconomic picture, does not ensure that the real resources to fulfill our commitments will be there. For example, if we buildup the assets in the Social Security trust fund, thereby achieving solvency, but offset those efforts by reducing saving elsewhere, then the real resources required to meet future benefits will not be forthcoming from our economy. In the end, we will have accomplished little in preparing the economy to meet future demands. Thus, in addressing Social Security's imbalances, we need to ensure that measures taken now to finance future benefit commitments represent real additions to national saving.

We need, in effect, to make the phantom "lock-boxes" around the trust fund real. For a brief period in the late 1990's, a common commitment emerged to do just that. But, regrettably, that com-

mitment collapsed when it became apparent that in light of a less favorable economic environment, maintaining balance in the budget excluding Social Security would require lower spending or higher taxes.

Last year, Social Security tax revenues plus interest exceeded benefits by about $150 billion. If those funds had been removed from the unified budget and "locked-up" had Congress had not made any adjustments in the rest of the budget, the unified budget deficit would have been $564 billion. A reasonable hypothesis is that the Congress would, in fact, have responded by taking actions to pare the deficit. In that case, the end result would have been lowered government dissavings and correspondingly higher national savings. A simple reshuffling from the unified accounts to the lock-boxes would not have, in itself, added to government savings; but higher taxes or lower spending would have accomplished that important objective.

The major attraction of personal or private accounts is that they can be constructed to be truly segregated from the unified budget and, therefore, are more likely to induce the Federal Government to take those actions that would reduce public dissavings and raise national savings. But it is important to recognize that many varieties of private accounts exist with significantly different economic consequences. Some types of accounts are virtually indistinguishable from the current Social Security system, and the Congress would be unlikely to view them as truly off-budget. Other types of accounts actually do transfer funds into the private sector as unencumbered private assets. The Congress is much more likely to view the transfer of funds to these latter types of accounts as raising the deficit and would then react by taking measures to lower it.

Failure to address the imbalances between our promises to future retirees and our ability to meet their promises would have severe consequences for the economy. The most recent projections by the Office of Management and Budget show that spending on Social Security, Medicare, and Medicaid will rise from about 8 percent of Gross Domestic Product today to about 13 percent by 2030. Under existing tax rates and reasonable assumptions about other spending, these projections make clear that the Federal budget is on an unsustainable path, in which large deficits result in rising interest rates and ever-growing interest payments that augment deficits in future years. But most important, deficits as a percentage of GDP in these simulations rise without limit. Unless the trend is reversed, at some point these deficits would cause the economy to stagnate or worse. Closing the gap solely with rising tax rates would be problematic; higher tax rates rarely achieve a comparable rise in tax receipts, and the level of required taxation could in itself severely inhibit economic growth.

In light of these sobering projections, I believe that a thorough review of our commitments and at least some adjustment in those commitments is urgently needed. The necessary adjustments will become ever more difficult and larger the longer we delay. No changes will be easy. All programs in our budget exist because a majority of the Congress and the President considered them of value to our society. Adjustments will thus involve making trade-

offs among valued alternatives. The Congress must choose which alternatives are the most valued in the context of limited resources. In so doing, you will need to consider not only the distributional effects of policy changes, but also the broader economic effects on labor supply, retirement behavior, and the national saving. The benefits to taking sound, timely action could extend many decades into the future.

Thank you very much, Mr. Chairman. I look forward to your questions.

For release on delivery
10:00 a.m. EST
March 15, 2005

Statement of

Alan Greenspan

Chairman

Board of Governors of the Federal Reserve System

before the

Special Committee on Aging

United States Senate

March 15, 2005

Mr. Chairman, Senator Kohl, and members of the Committee, I am pleased to be here today to discuss the issues of population aging and retirement. In so doing, I would like to emphasize that the views I will express are my own and do not necessarily represent those of the Federal Reserve Board.

The economics of retirement are straightforward: Enough resources must be set aside over a lifetime of work to fund consumption during retirement. At the most rudimentary level, one could envision households actually storing goods purchased during their working years for use during retirement. Even better, the resources that would have otherwise gone into producing the stored goods could be diverted to the production of new capital assets, which would produce an even greater quantity of goods and services for later use. In the latter case, we would be raising output per worker hour, our traditional measure of productivity.

The bottom line in the success of all retirement programs is the availability of *real* resources at retirement. The financial systems associated with retirement plans facilitate the allocation of resources that supply retirement consumption of goods and services; they do not produce goods and services. A useful test of a retirement system for a society is whether it sets up realistic expectations as to the future availability of real resources and, hence, the capacity to deliver postwork consumption without overly burdening the standard of living of the working-age population.

In 2008, the leading edge of what must surely be the largest shift from work to retirement in our nation's history will become evident as some baby boomers become eligible for Social Security. According to the intermediate projections of the Social Security trustees, the population 65 years of age and older will be approximately 26 percent of the

adult population in 2030, compared with 17 percent today. This huge change in the structure of our population will expose all our financial retirement systems to severe stress and will require adjustments for which there are no historical precedents. Indeed, retirement, generally, is a relatively new phenomenon in human history. Average American life expectancy a century ago, for example, was only 47 years. Relatively few of our citizens were able to enjoy many postwork years.

One consequence of the sizable baby boom cohort moving from the workforce to retirement is an inevitable slowing in the growth of gross domestic product per capita relative to the growth of output per worker. As the ratio of workers to population declines, so too must the ratio of output to population, assuming no change in the growth of productivity. That result is simply a matter of arithmetic. The important economic implication of that arithmetic is that, with fewer workers relative to dependents, each worker's output will have to support a greater number of people. Under the intermediate population projections of the Social Security trustees, for example, the ratio of workers to total population will shrink about 7 percent by 2030. This shrinkage means that, by 2030, total output per person will be 7 percent lower than it would be if the current population structure were to persist. The fact that a greater share of the dependents will be elderly rather than children will put an additional burden on society's resources, as the elderly consume a relatively large share of per capita resources, whereas children consume relatively little.

This inevitable drop in the growth rate of per capita GDP relative to the growth of productivity could be cushioned by an increase in labor force participation, which would boost the ratio of workers to population. Increasing labor force participation seems a natural

response to population aging, as Americans not only are living longer but are also generally living healthier. Rates of disability for the elderly have been declining, reflecting both improvements in health and changes in technology that accommodate the physical impairments that are associated with aging. In addition, work is becoming less physically strenuous and more demanding intellectually, continuing a century-long trend toward a more conceptual and a less physical economic output.

Despite the improving feasibility of work at older ages, Americans have been retiring at younger and younger ages. For example, in 1940, the median age of retirement for men was 69; today, the median age is about 62. In recent years, labor force participation among older Americans has picked up somewhat, but it is far too early to determine the underlying causes of this increase. Rising pressures on retirement incomes and a growing scarcity of experienced labor could induce further increases in the labor force participation of the elderly and near-elderly in the future. In addition, policies that specifically encourage greater labor force participation would also lessen the necessary adjustments to consumption. Workers nearing retirement have accumulated many years of valuable experience, so extending labor force participation by just a few years could have a sizable impact on economic output.

Another way to boost future standards of living is to increase saving.[1] We need the additional saving in the decades ahead if we are to finance the construction of a capital stock that will produce the additional real resources needed to redeem the retirement claims of the baby boomers without having to severely raise claims on tomorrow's workers.

---

[1] Additionally, we could borrow from abroad, which would build up the capital stock. In so doing, however, we would also build up a liability to foreigners that we would have to finance in the future.

However, by almost any measure, the required amount of saving that would be necessary is sufficiently large to raise serious questions about whether we will be able to meet the retirement commitments already made. Much has been made of shortfalls in our private defined-benefit plans, but the gross underfunding currently at $450 billion, although significant as a percentage of the $1.8 trillion in assets of private defined-benefit plans, is modest compared with the underfunding of our publically administered pensions.

At present, the Social Security trustees estimate the unfunded liability over the indefinite future to be $10.4 trillion. The shortfall in Medicare is calculated at several multiples of the one in Social Security. These numbers suggest that either very large tax increases will be required to meet the shortfalls or benefits will have to be pared back.

Because benefit cuts will almost surely be at least part of the resolution, it is incumbent on government to convey to future retirees that the real resources currently promised to be available on retirement will not be fully forthcoming. We owe future retirees as much time as possible to adjust their plans for work, saving, and retirement spending. They need to ensure that their personal resources, along with what they expect to receive from government, will be sufficient to meet their retirement goals.

Conventional advice from personal-finance professionals is that one should aim to accumulate sufficient resources to provide an overall replacement rate of about 70 percent to 80 percent in retirement. Under current law, Social Security promises a replacement rate of about 42 percent for workers who earn the economywide-average wage each and every year through their careers and about 56 percent for low-wage workers who earn 45 percent of the

economywide-average wage.[2] Assuming that taxes are capped at the current 12.4 percent of payroll, revenues will be sufficient to pay only about 70 percent of current-law benefits by the middle of this century. Thus, for the average worker, a replacement rate of only about 30 percent would be payable out of contemporaneous revenues, assuming that benefit reductions are applied proportionately across the board. For a low-wage worker, the payable replacement rate would be about 40 percent. Assuming that the goal is still to replace 70 percent to 80 percent of pre-retirement income, average workers by the middle of this century should be aiming to replace about 45 percent of their pre-retirement income, rather than today's 33 percent, out of some combination of private employer pension benefits and personal saving.

The required increases in private saving would be less to the extent that Social Security tax increases are part of the solution. However, to avoid any changes in replacement rates, the Social Security tax rate would have to be increased from the current 12.4 percent to about 18 percent at the middle of the century.

* * *

Once we have determined the level of benefits that we can reasonably promise, we must ensure that we will have the real resources in the future to fulfill those promises. When we evaluate our ability to meet those promises, focusing solely on the solvency of the financial plan is, in my judgment, a mistake. Focusing on solvency within the Social Security system, without regard to the broader macroeconomic picture, does not ensure that the real resources to fulfill our commitments will be there. For example, if we build up the assets in

---

[2] The replacement rate is the ratio of social security benefits to wages in the year preceding retirement.

the Social Security trust fund, thereby achieving solvency, but offset those efforts by reducing saving elsewhere, then the real resources required to meet future benefits will not be forthcoming from our economy. In the end, we will have accomplished little in preparing the economy to meet future demands. Thus, in addressing Social Security's imbalances, we need to ensure that measures taken now to finance future benefit commitments represent real additions to national saving.

We need, in effect, to make the phantom "lock-boxes" around the trust fund real. For a brief period in the late 1990s, a common commitment emerged to do just that. But, regrettably, that commitment collapsed when it became apparent that, in light of a less favorable economic environment, maintaining balance in the budget excluding Social Security would require lower spending or higher taxes.

Last year, Social Security tax revenues plus interest exceeded benefits by about $150 billion. If those funds had been removed from the unified budget and "locked up" and Congress had not made any adjustments in the rest of the budget, the unified budget deficit would have been $564 billion. A reasonable hypothesis is that the Congress would, in fact, have responded by taking actions to pare the deficit. In that case, the end result would have been lowered government dissaving and correspondingly higher national saving. A simple reshuffling from the unified accounts to the lock-boxes would not have, in itself, added to government savings; but higher taxes or lower spending would have accomplished that important objective.

The major attraction of personal or private accounts is that they can be constructed to be truly segregated from the unified budget and, therefore, are more likely to induce the

federal government to take those actions that would reduce public dissaving and raise national saving. But it is important to recognize that many varieties of private accounts exist, with significantly different economic consequences. Some types of accounts are virtually indistinguishable from the current Social Security system, and the Congress would be unlikely to view them as truly off-budget. Other types of accounts actually do transfer funds into the private sector as unencumbered private assets. The Congress is much more likely to view the transfer of funds to these latter types of accounts as raising the deficit and would then react by taking measures to lower it.

* * *

Failure to address the imbalances between our promises to future retirees and our ability to meet those promises would have severe consequences for the economy. The most recent projections by the Office of Management and Budget show that spending on Social Security, Medicare, and Medicaid will rise from about 8 percent of GDP today to about 13 percent by 2030.[3] Under existing tax rates and reasonable assumptions about other spending, these projections make clear that the federal budget is on an unsustainable path, in

---

[3] The projections for Medicare and Medicaid should be viewed as highly uncertain. Health spending has been growing faster than the economy for many years, the growth fueled, in large part, by significant increases in technology. How long this trend will continue is extremely difficult to predict. We know very little about how rapidly medical technology will continue to advance and how those innovations will translate into future spending. Technological innovations can greatly improve the quality of medical care and can, in some instances, reduce the costs of existing treatments. But because technology expands the set of treatment possibilities, it also has the potential to add to overall spending--in some cases, a great deal.

In implementing policy, we need to be cognizant that the uncertainties--especially our inability to identify the upper bound of future demands for medical care--counsel significant prudence in policymaking. The critical reason to proceed cautiously is that new programs quickly develop constituencies willing to fiercely resist any curtailment of spending or tax benefits. As a consequence, our ability to rein in deficit-expanding initiatives, should they later prove to have been excessive or misguided, is quite limited. Thus, policymakers need to err on the side of prudence when considering new budget initiatives. Programs can always be expanded in the future should the resources for them become available, but they cannot be easily curtailed if resources later fall short of commitments.

which large deficits result in rising interest rates and ever-growing interest payments that augment deficits in future years. But most important, deficits as a percentage of GDP in these simulations rise without limit. Unless the trend is reversed, at some point these deficits would cause the economy to stagnate or worse. Closing the gap solely with rising tax rates would be problematic; higher tax rates rarely achieve a comparable rise in tax receipts, and the level of required taxation could in itself severely inhibit economic growth.

In light of these sobering projections, I believe that a thorough review of our commitments--and at least some adjustment in those commitments--is urgently needed. The necessary adjustments will become ever more difficult and larger the longer we delay. No changes will be easy. All programs in our budget exist because a majority of the Congress and the President considered them of value to our society. Adjustments will thus involve making tradeoffs among valued alternatives. The Congress must choose which alternatives are the most valued in the context of limited resources. In doing so, you will need to consider not only the distributional effects of policy changes but also the broader economic effects on labor supply, retirement behavior, and national saving. The benefits to taking sound, timely action could extend many decades into the future.

The CHAIRMAN. Thank you, Chairman Greenspan. Your insights are always very helpful. The insight that I seek from you now comes from your experience in leading the former Greenspan Commission that saved Social Security the last time. As someone who has tried to keep his powder dry, to listen to the arguments for and against what the President has proposed and then seeing the political temperature go up on both sides, I for one am disappointed that there is not a more constructive environment in which to consider all that you have just shared with us.

I wonder if you see any parallels to your experience in the early eighties and whether something like a Greenspan Commission could be useful to us now. Can you also share with us your experience in the early eighties and perhaps suggest to us some process, that you found helpful and was to avoid things that are hurtful to an ultimately good result in saving Social Security?

Mr. GREENSPAN. I think the experiences we had in 1983 are relevant today, and the reason I say that is that it was not the usual Presidential or national commission which regrettably too often ends up with a thick report which nobody reads. It was constructed in a quite unusual way. We had, in effect, a bipartisan commission, obviously, with many members of the Senate and the House as well as the private citizens, and we decided to construct the system in such a manner that rather than have a commission which would deliberate, produce a report, present it to the Congress and the President, we decided to work interactively and we set it up in a manner in which Bob Ball, who is a very, very well respected Social Security analyst and commissioner of many decades back and is still around, functioning as effectively as always, essentially reported and kept in constant contact with Speaker O'Neill, and I did the same for the President, President Reagan, and Jim Baker, his then Chief of Staff, and we deliberated in a way which was really quite fascinating Claude Pepper's name was mentioned earlier. Claude Pepper actually set the commission on a very important path, because I, frankly, had assumed that the first meeting of the commission, which as you may recall confronted a Social Security trust fund which was rapidly declining which would have required benefit cuts, I thought it would be the politically easiest thing to do to just merely avert to general revenues, and I feared that that was what would indeed happen.

Claude Pepper said no. He said let us keep this as a social insurance system, let us keep this in the form in which it is, and in so doing, he in a sense basically set the parameters of the discussion, which was we have a problem; we have a deficit; there are only two ways to resolve it. You raise taxes or you reduce spending.

Now, you may think that once we came to that conclusion, it became very easy, but we actually spent a good deal of time trying to find ways to essentially repeal the laws of arithmetic. Until we finally got to position that we had to do various things, we were in common contact in bringing both the Speaker and the President up to date and we must say locking in the decisionmaking process. When we finally came to a conclusion, it was a simultaneous conclusion, essentially, between the Speaker and the President and the commission. When we appeared before the Congress, Bob Ball and I decided that we had to present the commission's findings as

unamendable, essentially, because it was a compromise, because if you started to amend it, the whole thing would unravel.

So what we did is I said when Republicans ask you a question, I will answer, and I trust you will do the same when Democrats ask me a question. So we stood side by side with the President and the Speaker and essentially eventually got an agreement on the substance of what the particular recommendations were. There were a whole series of potential recommendations, and we could have chosen from a family of any solutions, but we finally decided on one by a fairly large majority. As a consequence of that, when presented to the Senate and to the House, the types of amendments which were applied were more operational rather than substantive, and the process worked.

Do I think this is a possibility this time? I certainly hope so. I do recognize that the degree of differences seem at least on an audible level to be larger than they were back in 1983, but I suspect in principle not, because this is not a hugely difficult problem to solve, certainly no more difficult than in 1983. I guess what is missing is the fact that at this stage, there has been a rather low interest in actually joining together and finding out where some of the agreements are, and I have a suspicion that if it occurs, that will happen.

The CHAIRMAN. I suspect it will also, because when you look at the larger category of our topic today, not just Social Security but also Medicare, I suspect it will be some time within 10 years that these programs in combination will begin consuming so much of the Federal budget that Republicans and Democrats are going to have to come up with a process, perhaps not unlike what you have experienced and shared with us this morning, that will come to the rescue of our nation's economy; but right now, I think there is a lot of politics playing out, and frankly it is unfortunate we can't get to it sooner rather than later. Hopefully, your presence here today will help us get to it sooner.

Senator KOHL.

Senator KOHL. Thank you, Mr. Chairman. Senator Clinton has to be departing shortly, and on our side, I would like to give her an opportunity to make her comments, and ask her questions at this time.

Senator CLINTON. Thank you very much, Senator, and I appreciate your kindness.

Chairman Greenspan, I sat and listened to your testimony and I obviously took great note of it and particularly your statement on page 6 about the brief period in the late 1990's when a common commitment emerged to make the fantom lock boxes around the trust fund real. I remember serving on the budget committee 4 years ago in the spring of 2001 when your testimony helped blow the lid off the lock boxes when it came to the size of the tax cuts, the extent of the tax cuts.

In addition to the tax cuts, without the real opportunity to continue to pay down the debt and the deficit, we did away with pay-go rules. So we essentially have been in a free fall ever since and we are still in that free fall, and I think that your testimony today is a little nostalgic for me, and I regret that we are in the position we are in.

I want to ask you two questions. First, in your previous testimony before Congress, you have stated before the Banking Committee on February 16, that you would be very careful about very large increasing debt, characterizing anything over a trillion dollars as large. I guess we are now into multiple zeroes when we think about what is large and what is not. The President's plan in so far as we know it to privatize Social Security will increase the debt by almost five trillion over 20 years.

Setting aside the fundamental debate over diverting money out of Social Security, what do you think about establishing private accounts without paying for them, but instead by borrowing yet more money; and second, if we were to enact the privatization proposal such as the one the President is suggesting, what responsibility do you recommend the Federal Government have for workers who retire in years when the stock market is down and face a significant reduction in benefits? What about the other pieces of the mission of Social Security, namely the disability and survivor benefits? How do we ensure that they are fair and adequate in a privatized system?

In fact, this is not a hypothetical question. If you look at the fact that between March 2000 and April 2001, the S and P 500 fell by 424 points or 28 percent, if Social Security had been privatized, the worker who had his or her individual account invested in a fund that mirrored the S and P 500, which in many respects is a preferred investment, and who retired in April 2001 would have 28 percent less to live on for the rest of his or her life.

So I would appreciate your response to both of those questions.

Mr. GREENSPAN. Well, Senator, let me first comment that with respect to the 2001 period, I actually went back and reviewed the testimony that I gave in January of 2001, and we were confronted at that time with an almost universal expectation amongst experts that we were dealing with a very large surplus for which there seemed to be no end, and that was true of the best analysts in the Office of Management and Budget and the Federal Reserve, and the question was what do we do when we get in a very rapid decline and a level of debt outstanding when we are about to approach zero and create some significant distortions in the system how to allocate assets.

I argued back then that excessive on-budget surpluses distorted the private system and we should try to eliminate them. I did indicate that we should have a scheduled tax cut, and the reason for that was in order to reduce the surplus. I also indicated that there was the possibility—indeed, the language is fairly strong in some cases—that we may be fooling ourselves, that, in fact, deficits are coming back, and I therefore recommended that we have some form of trigger to readjust if, indeed, that happens. Subsequently, I have been a very strong supporter of pay-go, and so in all tax cuts and all expenditure increases, I have held the position that we have to pay for them one way or another or we are creating serious problems.

So I don't think that the issue is a question of taking a wholly different view. I look back and I would say to you if confronted with the same evidence we had back then, I would recommend exactly what I recommended then. It turns out we were all wrong.

We were wrong largely because even though we had pay-go in place, we underestimated how that would erode.

With respect to the particular issues that you raise, specifically with respect to private accounts, I think pay-go is applicable here as well. I think there are very tricky questions which the Congressional Budget Office has raised relative to how they would be scored, but they have to be under the same rubric.

With respect to the question of people with private accounts which are invested in equities at the time they retire, that would be a very unfortunate mistake, and I think any private account of which I am aware would restrict the amount of highly volatile-priced securities in the last 10 years of work. So I don't think that issue is real. I do agree with you that were it to happen, it would be very disabling, but that is easy to cure.

On the issue of disability and survivors, I think that is an issue that we have to handle. In other words, we don't essentially eliminate those obligations. I think we address them in many other ways, and I think that is perfectly feasible to do, and I do believe you need a safety net under the system.

So private accounts are coming in all sizes and shapes. I don't know exactly what the President is going to propose. I do believe that whatever is proposed should be as small as possible, because we do not know, as I have indicated in past testimony, how the market will react to the increase in the budget deficit that will be reported on a unified budget basis. Until we know that, I think we are taking potential risks with private accounts, and my testimony in the past is that we should start very slowly and see whether, in fact, it is disruptive. If it is, we had better very quickly reverse.

Senator CLINTON. Thank you, Senator Kohl.

Just for the record, we were not all wrong.

The CHAIRMAN. If there is no objection, we will go back and forth, again on time of arrival. So the next questioning goes to Senator Craig and then Senator Wyden.

Senator CRAIG. Again, Mr. Chairman, we appreciate your comments, your both broad view of where we are and our responsibilities and your candid application of your experience to that.

We have visited before about the demographics of aging and its impact on economies and countries. We see this phenomenal shift that is occurring out there, and you have talked about the historic numbers of retirements that will occur and their impact upon the economy. Some other nations, like Japan and western Europe, are preceding us down that demographic road. How instructive are any of the experiences they have had to us?

Mr. GREENSPAN. Well, Senator, as you know, there is a very substantial variation in how retirement is handled around the world. Obviously, the demographic problems in some European nations are far worse than ours, and clearly that is also the case in Japan. They are handling them in a number of different ways. There are a lot of private accounts or a lot of mixed accounts. There are many different ways of approaching the issue, and I think we should endeavor to get to where we wish to be in resolving these very broad questions.

We need to examine the experiences of other countries. We have to remember, however, that our culture is different. There are dif-

ferent views and different ways in which we handle things, and so the actual experience of others is not necessarily useful, but I do think it is worthwhile looking at it because I think we will find types of things not to do as well as what to do.

Senator CRAIG. Last, Mr. Chairman, in part, the 1983 reforms intended to make the system solvent for the long term by increasing government savings. This was supposed to involve large Social Security surpluses being used to buy down Federal debt during the early 21st Century. Today's trend lines for future generations show both declining Social Security solvency and growing Federal debt. Does this imply that for the sake of future retirement security, we would do to better to incentivize personal savings than to pin our hopes on government savings?

Mr. GREENSPAN. Well, Senator, as I pointed out in my prepared remarks, 30 million Americans will turn 65 over the next 25 years, we have the arithmetic that we cannot get around and the demographics we cannot get around, that is very great pressure on the replacement rate from Social Security to fall, meaning the amount of income we get as benefits relative to the amount of income we had in our last years of work.

This means that we have to look beyond Social Security into other ways of creating retirement assets and sources of funds, because we either raise Social Security taxes to an extraordinarily high level, which remember is a tax on individuals and businesses and there are competitive issues here which we have to be aware of or we cut benefits. So I think it is very important to recognize that we have to look beyond Social Security for means of retirement income, and I think here we have to be especially careful to make certain that those who have inadequate resources essentially are held harmless in the adjustment, which we can actually do.

But it is important that we, instead of trying to solve just the Social Security problem, we look at the broader issues of retirement income. I think having Social Security on the table and resolved fairly quickly is where we ought to go for exactly the reason you and I discussed a while back, not that Medicare is not the far larger and far more difficult problem, but rather is it probably sequentially better to get Social Security out of the way, because it is essentially a defined benefit program. We know its parameters. We know it has to be resolved, and that can be done.

Medicare is going to turn out to be a far more difficult issue, which will require more time than we thought, and I believe probably more than one commission and more than one effort to get there.

Senator CRAIG. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kohl, I believe is next.

Senator KOHL. Thank you, Mr. Chairman. Out of respect to all my colleagues, I will just ask one question, and it relates to your response to the previous question.

You know the most likely outcome with respect to this Social Security issue today is probably a deadlock. There is so much partisanship that has been injected into it that practical realities dictate that at some point in the near future, in order to just move

on with all the problems that we face here in Washington, we will just have to put it aside, and that would be most unfortunate.

That would be an unacceptable outcome, because Social Security, as you have said, is not the only the problem we face. We need to talk about Medicare, Medicaid, tax policies, and spending policies. When I talk to my constituents back home and make the comment that what we need is a debate about how we are going to raise money and spend money in a manner that will enable us to move forward in a more constructive fashion in the years to come, they all agree that we desperately need to have this debate.

Don't you think that we need to have a debate at this time not only about Social Security, but about these other issues, even if that debate takes a year or two? In order to have that debate, wouldn't you agree that we need to establish here in Washington, starting with the Administration, a truly bipartisan atmosphere that will elicit the cooperation and the best ideas from members on both sides of the aisle, just as you did in 1983? In order for this debate to happen—whether it be on Social Security or on all these other issues—don't we have to have a different kind of approach than the one that we are pursuing with respect to Social Security at this time?

Mr. GREENSPAN. Senator, I think it is essential that whatever solution we come up be bipartisan, because there is no second alternative, and unless we do that, we won't resolve these particular issues. I think that we have a deadline which is early 2008, and that is when we begin to get the leading edge of a fairly significant cohort of the baby boom generation moving into retirement. Any agreements that are made will apply to them, and I think it is important to get those in place before the cohort of baby boomers starts to retire. I sense, and I may be a little more optimistic that perhaps is realistic, that there is a growing awareness of where the differences are and where the general agreements are, and it may well be that some mechanism such as that which we employed in 1983 may be a useful mechanism to get groups together and find out where there are agreements.

I think that what tends to happen in these debates is nobody talks about what they agree about, but only about what they differ about, and something has got to give soon because we don't have the choice of not resolving these issues, because with the inexorable turn of the calendar, we are going to be running into the Year 2008, and there is a great deal to be done, and I would hope we could get Social Security behind us and begin to really address the medical issue, because I think this is the crucial issue which will confront this Congress and this President over the years immediately ahead.

Senator KOHL. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Next, Senator Collins and then Senator Wyden.

Senator COLLINS. Thank you Mr. Chairman. Dr. Greenspan, your testimony provided an excellent overview of the demographic changes in this country that compel us to act to ensure the future solvency of the Social Security system. One of the recommendations that came out of the 1983 Greenspan Commission was an increase from the retirement age over a gradual period of time from 65 to

67, and again this time, we hear a lot of experts saying in light of the fact that people are living longer, we should take a look at a further increase in the retirement age to 68, 69, or even 70.

I personally have a lot of concerns about that because we have a lot of individuals in this country who work in physically demanding jobs, and I wonder it is practical or realistic to expect them to continue working in their late sixties. But I am wondering why there isn't more focus on the early retirement age of 62. We know that half of those who are eligible do begin receiving benefits at age 62.

Should we be taking a look at the early retirement age as opposed to what seems to be an exclusive focus on raising the age from 67 to some increased number?

Mr. GREENSPAN. Well, Senator, I think one of the advantages of having a commission with a staff who are experts on a lot of these issues is to actually array all of the alternatives that are available. That is what they did for us in 1983. We had an excellent staff. We now would presume that most of the people who are involved in taking early retirement are those in arduous jobs. I am not sure all of them are by any means, but I am reasonably convinced that a significant amount of those retiring from arduous jobs are probably getting more benefits in the sense that they tend to be in the, say, lower three quintiles of the distribution, and what you could do is very simply to try to adjust, for example, for individuals who choose to retire particularly early. You will find that their benefits will tend on average to be higher, but one of the things that will show up no matter what you do is every particular fix on the problem we have is essentially unacceptable; and therefore, as I indicated previously, what you need is a recognition that these are all choices among relatively unfavorable outcomes, and we don't have the choice not to choose.

The problem is out there. What is forcing us is demography, and we cannot get around the fact that a very large cohort of the American population will retire, and when they do, it will have very extraordinary effects on the finances of the system, and therefore we must fix it, and every fix is unacceptable. So you run into a contradiction which gets resolved only by recognizing it is not a choice of what you would like to do, but a whole set of choices of what you would least like to do.

Senator COLLINS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Dr. Greenspan, you heard my comments about this weakening dollar, and it seems to me it pounds the seniors and the near seniors with a double whammy. First, they have always looked for safety. They have always looked for instruments that are safe, and now they are being advised to start looking at CDs and savings accounts, foreign CDs and savings accounts.

Second, we are having this big debate, as we should, about generating more savings for the future, and it seems to me the weakening dollar debate doesn't make people feel very confident about saving for retirement when they hear constantly about the uncertainly triggered by our dollar policies. So my question to you is have we reached the point out now with respect to the dollar where

seniors should go out and follow the recommendation by a very authoritative person in Newsweek, go out and buy foreign CDs? Have we reached this point?

Mr. GREENSPAN. Senator, such recommendations presume that you can forecast the exchange rate of the dollar over an intermediate period. We at the Federal Reserve have expended an extraordinarily large amount of resources to try to forecast the value of the dollar in foreign exchange markets, and we have determined it is an exceptionally difficult thing to do, and as I like to put, it, we have been no more successful than the odds you get in tossing a coin.

So it is rank speculation for a senior or anybody else to buy foreign CDs. You can certainly say that the dollar declined since the end of 2002 and had one bought CDs back then and sold them today, you would make a profit, but we are looking forward and looking forward in my judgment does not tell us terribly much about where we are going.

But you do raise, I think, a very important question, which is the tie-in here of our current account deficit and the issue of savings. One of the reasons not the sole reason, but one of the reasons, why we have a very large trade deficit and essentially a very large current account deficit, is that we don't save enough in the United States and are required to borrow funds from abroad, borrow savings from abroad, to finance the capital investment we need to create the productivity gains that we see. By focusing on increasing national savings as part of the problem for retirement, we do go a long way in creating balance in our international accounts, and it would be a significant factor in the reduction in our current account balance.

But I leave aside the issue of trying to forecast and trying to anticipate how exchange rates will go, because it is remarkable how many people are unequivocal in their forecasts, and when we look at the actual performance of those forecasts over time, they are no better than chance.

Senator WYDEN. I just have seen that you have said that dealing with this weakening dollar is somehow going to be orderly, and I will tell you I see bedlam out there, and I think it is going to be very hard to get people to save and to cultivate the kind of savings ethic that you and I want to see and that there is bipartisan support for until we get our arms around a sensible dollar policy.

I want to ask about the health care issue also, because people have differences of opinion. I understand that, but I just for the life of me don't get the logic in your approach to health care. You have told us that health care is more serious and you have told us that it is going to hit more immediately, but then you say, "Gosh, let us do Social Security first." Well, Senator Hatch and I have authored a law that is now being implemented as we speak to essentially walk the country through the choices with respect to health care. It is going to be on line. It is going to be available in senior centers and the libraries and the like so that people can see where the health care dollar goes and what the alternatives would be.

Wouldn't it be more sensible, given the fact that that is going to hit in 2010 rather than 2040, for us to move with a sense of urgency on the health care issue? I mean, we have got a law that al-

lows us to walk the country through the choices and the tradeoffs. It is now being carried out. Wouldn't it be smarter to do that first?

Mr. GREENSPAN. Well, Senator, first, I was somewhat taken back when you at the very beginning had indicated that I had said so little about Medicare in my prepared remarks, and of course you are right. I didn't mean to do that. I think it is a very serious issue; however, let me follow on to what you have said. I think what we have a problem in Medicare or medical systems generally in that we don't know as much about what is going on as we need to know to resolve and reform a lot of the difficulties with respect to respect to systems.

Because of the private physician-patient relationship, there has been very little in the way of collection of data about various different clinical practice. We do know that the samples that have been taken would indicate that we have very considerable differences in clinical practice across the country with very significant differences in outcomes as well.

What we need to do sequentially to address the medical problem generally, which is Medicare and Medicaid as well as other aspects of medical professional issues, is to know what is going on. Here, I think if we can get a major advance, as now seems to be underway, in a bipartisan manner to improve the information technology associated with the medical systems and get bodies of individual biographies encrypted as we can now do such that we know what is medical best practice that is an important first step. I think that if we were to jump in and reform the system overall before we know what the actual structure of the medical practice is, I think we risk having to backtrack, and what I am concerned about is we will put solutions, in quotes, in place which are inappropriate.

I think I agree with you. I think the medical issue is urgent and that we should be moving very quickly, as I believe we will be and are, to get information technology very broadly applied in medical practice, and when we do that, I do think we will move fairly quickly to understand what medical best practice is so that when we construct the proper Medicare system, we are dealing with the facts at the time. I am worried about putting in wrong practices which have to be reversed and technologies which have become obsolete.

Senator WYDEN. I would only say, Dr. Greenspan, and my time is up, that I continue to disagree. The point about medical technology is indisputable, but the Journal Health Affairs, for example, says that we might perhaps save $98 billion to go forward with the information that would come about as a result of our knowing more about various parts of practice in the health care system. It is a $1.8 trillion system, and so the debate about issues of like end of life care, what to do about administrative costs in health care, which many say are something like a third of the $1.8 trillion, that can't afford to wait.

So I respect your view with respect to the issue and importance of health care technology, but I think we are dead wrong, dead wrong, to say we are going to start now on a problem that we have got to deal with 20, 30, years from now when on New Year's Day 2008, something like 70 million baby boomers start retiring, and those health care costs are going to ramp in very fast. They are

going to hit this country very hard. I have enormous respect for you, but I do not think that the sense of urgency about health care is being conveyed, and I hope that we can talk further about that.

Mr. GREENSPAN. Well, Senator, let me just say that I think there is much less a difference between your views and mine than I think you have expressed. I don't really, in all honesty, disagree with anything you have just said. It doesn't contradict anything I believe I have said. If you can find a way to move forward on this thing in a productive manner, I think it would be terrific for this country.

The CHAIRMAN. Thanks, Senator Wyden.

Senator Burns and then Senator Jeffords.

Senator BURNS. Thank you, Mr. Chairman.

Mr. Greenspan, you are looking at two guys that have probably more time in information technology and the ability to move it, building the infrastructure for telemedicine and centralized records and all of these things. We have one American failing: We talk about the demographics here and how we are to preserve a system, and our feeling in American is just like if I come out and told Mr. Greenspan that he is going to have to re-roof his barn in 2015, would you sign the contract today.

Mr. GREENSPAN. No.

Senator BURNS. You wouldn't do that. That is one great American failing. We do not do anything until we are in a crisis, and the only thing that we will get done in this particular issue is that I think there is enough grandfathers and grandmothers who have another great American trait, and that is to think more of the next generation than they think of themselves, and that has always been a trait of America. We live for our kids and our grand kids, and I think that is a welcome sight among us who have started this debate. This debate has to start.

But you are right. We do not have all the time in the world. 2008 is sort of D-Day, and the events that that will lead to are not too promising, as far as policymakers are concerned, to do things now that we would soften that landing.

My questions have been asked by Senator Bayh and also reinforced by our chairman, so I will not go over that ground again, but I think we are going to depend on you, on what-ifs, and do we go into a personal situation that is an add-on to our retirement or is it a part of the system? I think when I heard Senator Moynihan many years ago predict that we would come to this point in our policy, that we will have to make those kind of decisions, and I just want to add that to the record, that we have the great American failing, but we also have a great American trait that is going to enable us to do that. It will take political courage, however, to do the things, and I agree that we have to not look at the things that we have to do, and there are options of things that we do not want to do, and that makes the problem a good bit more difficult.

So I thank you for your testimony today and I thank for the insight of my friends across the aisle, because I think as we take this to the American public on an issue that the American public has decided this is a part of our social fabric. It is a very desirable program, and how they understand it and how they perceive it will be up to us, and, of course, you know when you go out on the road,

it is just like any salesman would say. We don't buy cars; we buy benefits. We can get to A and B on anything, but we buy the benefits of air conditioning and those type of things, and I think that is another one of our great challenges.

Thank you for coming today. Your statement was insightful. I don't know of a Senator in this body that is not taking this very, very seriously, and somewhere in there comes an answer, and so I think you have further defined the focus and narrowed it to where I believe that this Congress, not discounting it, can muster the leadership to make those necessary changes.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Jeffords.

Senator JEFFORDS. It is good to see you again and to chat with you. In addition to focusing on replacement rates, personal finance professionals will also discuss diversification of assets and income streams for those contemplating retirement. Given the troubles you mentioned in the defined benefit pension system, I suspect that the ever growing share of retirees will have Social Security as their only defined benefit where they are not bearing the investment risk.

We certainly need to promote savings in any event, but from the retirees' perspective, shouldn't we maintain Social Security's defined benefit as strong as possible rather than swapping some portion of it for what essentially is a defined contribution plan?

Mr. GREENSPAN. Senator, the reason I think we have to look at a broad spectrum of possibilities before you come to final conclusions is the fact that we are confronted with a very unusual situation. This is unprecedented in my recollection of retirement financing in this country.

I think if you put together all of the various alternatives, it is up to Congress to make the types of judgments on issues that you are raising, and I think the crucial question, as I said in my prepared remarks, is which set of policies will create the national savings which will assure that the physical resources are there. It may well be that we can do it in the context of some changes in Social Security in the direction which you are suggesting. It may be that we need to move in other directions as well. But the underlying crucial issue and I would say, the main point that I am trying to make this morning is, let us not lose sight of the fact that finance is only a technical means to allocate resources. It presupposes we have them, and I think that is not self-evident given the nature of what is about to occur in this country with so large a segment of our work force retiring. I think we have to realize it creates very major pressures on real resources being produced.

The one thing that has got to be at the top of the list in any solution, whether it is more less Social Security, more or less 401(K)s or other means of financing, does it increase national savings, because that is really the only thing we can do which can counter the demographics over which we have no control.

Senator JEFFORDS. Do I have another shot?

The CHAIRMAN. You still have time.

Senator JEFFORDS. The New York times reported on Sunday that the Federal Reserve estimated that personal savings for any purpose amounted to a hundred billion last year while OMB put the

tax expenditures for retirement at 112 billion for the same year. I don't know if this is an apples to oranges comparison, but it certainly raises some good questions.

Mr. GREENSPAN. What was the hundred billion? I missed it.

Senator JEFFORDS. A hundred billion from OMB. I mean the Federal Reserve estimated that personal savings were a hundred billion.

Mr. GREENSPAN. I see. That is right. I saw that.

Senator JEFFORDS. Well, President Bush singled out maintaining favorable treatment for charitable contributions and mortgage interest in the context of tax reform, but he omitted retirement savings as a preferred category. How should we balance our desire for simplicity against our need to promote retirement savings, and do you have any thoughts on our current tax incentives for retirement savings?

Mr. GREENSPAN. Well, the problem is we have a great number of elements in the tax code which have created incentives for 401(K)s, IRAs, and a number of other different elements within the tax code which are supposed to enhance savings, but as you point out, our actual net household or personal savings last year was de minis, and the question is what is causing that, and that is a very considerable debate amongst economists and financial experts as to whether or not and to what extent these various tax incentives are creating savings.

We have, for example, situations around the world where are there negative savings. Australia, for example, has had negative savings for quite a while. It is a very tricky question, because we have increased market value of assets which people in retirement do not distinguish from what economists call savings, which is the difference between income and consumption, but we need to know a great deal more of how successful various incentives for increased savings, such as 401(K)s and IRAs, are. There is fairly significant dispute within the economics profession as to how important they are, and there are people on both sides of the question.

But I think you are raising an interesting issue. In one sense, it may be apples and oranges, but it is a very important question.

Senator JEFFORDS. Thank you very, very much for all you do for us.

Mr. GREENSPAN. Thank you.

The CHAIRMAN. Senator Bayh.

Senator BAYH. Thank you, Mr. Chairman. I would like to, having juggled my other meetings, pick up where I left off with my questions from my opening statement, beginning with the estimates for economic growth and productivity from the trustees and the apparent conundrum that it presents where their estimate for economic growth was 1.9 percent and for productivity, 1.6 percent over a long time horizon. If, in fact, they are accurate, that might suggest that market returns for private accounts would be correspondingly modest. If they are inaccurate and, in fact, the estimates should be higher, than perhaps the magnitude of the problem that we are addressing is not what it is currently estimated to be.

First of all, are they accurate in your opinion?

Mr. GREENSPAN. You mean are the numbers you quoted? I believe they are.

Senator BAYH. Those are the trustees estimates?

Mr. GREENSPAN. Yes.

Senator BAYH. The question is in your opinion whether they are unduly modest or do they reflect your own feelings for what may happen over the term?

Mr. GREENSPAN. When you project out 25 years, you are dealing with extraordinary uncertainty not with respect to the labor force, but with respect to productivity growth, and we have experienced obviously significant productivity growth in recent years, way beyond our normal expectations. History suggests that over very protracted periods, a country such as ours which is at the cutting edge of technology has difficulty increasing productivity say, more than 2½ or 3 percent a year.

Could the number be higher than what we are looking at? Of course, it could. It could also be lower. The critical question that must be answered, however, is how much in making changes would it affect the longer term. Remember that effectively leaving lags out, we are not promising nominal benefits for Social Security. We are promising real benefits. So if the economy is growing faster, not only are revenues rising, but so are the benefits. So you come out with questionable resolution.

There is some evidence that Medicare, for example, with the demand for Medicare services is a function of the real income in the society, so that if you get stronger growth, which is a perfectly credible forecast, you can't say that, therefore, growth solve the problem. I think it does in part. In other words, there is a lag between——

Senator BAYH. It helps some.

Mr. GREENSPAN. It helps some, but there is a tendency to exaggerate what the effect is.

Senator BAYH. The gist of my question was, and you have addressed it, is we have to pick some set of numbers, so best to give it their best shot and best, I suppose, to err on the side of caution rather than being too exuberant. So if they are accurate, these are fairly modest numbers, and it might suggest lower rates of market returns for those who advocate private accounts, and I suggest they should reflect that in their estimates of the returns.

Mr. GREENSPAN. Well, I think there are several questions there as well. Obviously, it is not a big issue with respect to bonds. The real interest rate will be affected, but not by a great deal, and while it is the case if you have a slower economy that profits will grow at a slower rate, but remember a very significant part as far as equities is concerned is the price-earnings ratio, and it is ambiguous, as to what that will do over time, and I wish we could forecast that better, but we don't seem to do all that well.

Senator BAYH. Well, that is true. Forecasting markets is inherently ambiguous, as you point out, but the P–E ratio has expanded over the last 10 years or so.

Mr. GREENSPAN. Yes, it has, and I will grant you that most analysts will say it is somewhat above normal or at normal or something like that. So you don't have the capability of starting at a very low P-E ratio and then expect significant rise.

But there are more people who forecast the stock market than forecast it accurately.

Senator BAYH. My two additional questions, Mr. Chairman, one deals with a couple of options, one of which I mentioned, for increasing the amount of savings. The first that I did discuss was moving from the presumption that workers would have to opt out of their savings program as opposed to being required to opt in, and that, apparently, according to research, would dramatically expand participation rates, but then you run into the problem that I suggested that those in the private sector have a problem with the success because it does require them to match the contributions and so forth.

I would be interested in your opinion about shifting the presumption, and if so, how do we address the ramifications of that for the business sector.

Second, there is something I didn't mention in my opening statement, and that is some have suggested for smaller businesses who find the cost of offering savings programs to be somewhat onerous, the cost of setting them up, that perhaps the employees of smaller businesses be allowed to participate in the thrift savings program offered by the Federal Government. There would not be a match, but they could make their own voluntary contributions in that. The small businesses wouldn't incur the cost of having to set up the program.

That might be one way to address the lack of savings or a lack of a vehicle for employees of small business, and I see the red light is now on, Mr. Chairman. So your reaction to those two ideas to increase private savings. The final question would be I would be interested if you had any reaction to Warren Buffet's observation that rather than an ownership society, if the current account imbalance continues on the way it is, we, in fact, may be creating in his words a sharecropper society. I would be interested to know if you had any reaction to his comments.

Mr. GREENSPAN. Warren is a good friend, and I sometimes agree. Sometimes I disagree, and I won't comment in this particular case on which it is.

Senator BAYH. In a private setting, I would be delighted to get your reaction.

Mr. GREENSPAN. Let me just say that we are having so much difficulty with creating private savings that any venture that we perceive can possibly add to it is worth looking at. I fear that the issue of the opt in and opt out is mainly a measure of the inattention of a number of people, and it is quite likely that you could start with they have to opt out, and you would find that it may be 90 percent, but within two years, is it down to 40.

I think it is interesting issue and I think it is certainly worthwhile looking at amongst other things, but anything that we can do to raise personal savings is very much in the interest of this country.

The CHAIRMAN. Senator Lincoln.

Senator LINCOLN. Thank you, Chairman Greenspan, for being here to visit with us here today. We hope it will be a continuing conversation.

I am the last of four children. So I am used to being last in line, and I am usually the youngest around here, so I am usually the last, but I also have to say that it gives me an added interest in

this topic, because in 20 years, I still will not have reached retirement age. So am I am very interested in all aspects of what we are dealing with here.

I want to say a very special thanks to our chairman, Chairman Smith, for holding this hearing and broadening the conversation, the context of how we are dealing with this in terms of exploring the economics of retirement, and as I mentioned earlier, I do think that we have to think of our nation's retirement as an entire puzzle and Social Security is just but one of those pieces of that puzzle.

I compliment my colleague, Senator Wyden, in bringing up the incredible part of this puzzle that is made up by health care cost, Medicare, Medicaid, personal savings as you have mentioned, but also long-term care with well over 75 percent of our long-term care in Arkansas, for our seniors there, is paid by Medicaid. So when you talk about the kind of cuts we are looking at in these programs as you talk about Medicare and how we look for best management practices and ways to hopefully bring down some of those costs in Medicare, prescription drugs as a preventive measure is an incredible piece. We have got to look at a way that we can do better in terms of providing prescription drugs at a lower cost to everyone, to all the tax payers, and I hope that that will be a part of this debate, certainly as we move forward and look at all of the different pieces of this puzzle, and we look forward to having your input there.

The couple of questions I had, Mr. Chairman, in 1983, Congress did follow your recommendations, of the commission, and raised the taxes to sure up Social Security, but as you know, Congress used at least a large part of the money that was raised from that tax increase to pay for general government expenditures, and what Social Security has been given in exchange for that $1.5 trillion worth of obligation or IOUs is just simply an IOU.

I guess first off, just to make sure I understand, would you agree or disagree that the 1983 tax increase has been used not for Social Security, but for the general government spending? I guess as we look forward into that, as you know, our progressive tax code, which is our income tax, is dedicated to funding the general fund. In terms of the progressivity of the tax system, what would be the impact on wage earners if Congress did not use progressive general fund taxes to pay Social Security back what it owed? If we don't honor the trust fund or more specifically that obligation or IOUs that exist held by the trust fund, are we shifting the tax burden from the rich to the poor?

Mr. GREENSPAN. If you have a significant so-called on-budget deficit, which we have experienced now for quite a long period of time, is it essentially saying that the addition to the Social Security trust fund is effectively being employed to finance other elements of the Federal Government and we are not creating any savings in the process.

Senator LINCOLN. So you are agreeing that the 1983 tax increase has not——

Mr. GREENSPAN. Regrettably, I do, yes. It is unfortunate, but it is a fact, and I thought what was sort of interesting, which I mentioned in my prepared remarks and Senator Clinton was mentioning, that there was a recognition that we ought to view Social

Security as a lock-box program in which we somehow insist that the on-budget is employed as the unified budget and that, as I indicated in another hearing, it would not be a bad idea to move the whole Social Security operation to the west coast, get it out of Washington, maybe even rename it so that nobody would discover where it was so that they could get at it.

But, regrettably, that has not been the fact, and I think that the since the ultimate test of a program is whether it is going to be adding to national savings, which in my judgment is the ultimate criterion, the ultimate test is whether government savings goes up or down, and unless you increase taxes or decrease spending, you will not get a decrease in government dissavings.

Senator LINCOLN. But we know we could eliminate all non-defense discretionary spending and still not be able to deal with the deficit spending that exists. So I guess, again, if we do honor the trust fund and the obligation, the IOU that exists there that is held by that trust fund, if we do it with anything other than the progressive dollars of our tax system, are we not shifting that tax burden again from the rich to the poor? Because the poor or the working poor are going to be those who end up paying back the very debt or the obligation that has is owed to them.

Mr. GREENSPAN. Well, actually, there is a commitment in law, as you know, to pay Social Security benefits where the only caveat is if the trust fund goes to zero. My own impression is that should that happen, something else will occur.

The question, however, is more an issue of taxation generally, and the Congress has the capacity if it perceives the incidence of taxation to be falling in the wrong places—and in the case that you are giving it is hard to tell exactly what is happening—then you have the obligation to make what changes you see fit.

Senator LINCOLN. Well, Mr. Chairman, if you will just indulge me for a second, we all have people out there in our lives who for whatever reason always want to borrow a little money from us, and many of us are sucker enough to loan it to them, and then, you know, all of a sudden when it comes time for them to pay that back that debt, there is a crisis, they have had an accident or the dog ate it or whatever, and they create this crisis that they are not willing to pay back the debt that they owe us for whatever the situation was. Then all of a sudden, we look down the street, and they are at the corner bar buying rounds for everybody, all their friends.

You know, whether it is making permanent tax cuts to the ultra wealth think or what have you, but it is very difficult then for those of us that continue to loan and to see those loans being made and then realize that simultaneously there is promises being made of drinks for everybody down the road.

So you are right. There are some difficult decisions to be made there and lots of concerns. I would like to associate myself with the comments from my colleague from Maine, Senator Collins, about the early retirement, because we do see that 20 percent of the beneficiaries between the ages of 62 and 64 do have health problems, and it is unfortunate we find that the early retirement program almost functions as an unofficial disability program.

So I would hope that we would definitely take that into consideration when we talk about extending that retirement, the benefits

in the retirement age, because for States like us, small rule States where predominantly much our workers are in physical, highly physical, jobs that do tend to present more disability percentage-wise in our population, that becomes a real issue.

Thank you, Mr. Chairman. We look forward to continuing our conversation.

Mr. GREENSPAN. Thank you very much, Senator.

The CHAIRMAN. Chairman Greenspan, just one other question and comment by myself.

I have heard you in the past speak about Social Security as we have it now and as you helped to reform it, you compared it to a 1957 Chevrolet in Havana, Cuba that keeps getting repaired and keeps running, but I think your point is there may be a better Chevrolet out there if we have enough foresight to go out and acquire it. That is a metaphor that you painted in my mind that sticks with me. You have described in your process as chairing the Greenspan Commission that you really couldn't get around the arithmetic. You kept coming back to the fact that you have to cut some benefits and you have to raise some taxes, which is essentially what happened.

But as I understand your recent comments and as someone who is trying to evaluate the merits and demerits of personal accounts as part of Social Security, I think I hear you giving qualified support for it.

Mr. GREENSPAN. That is correct. A pay-as-you-go system by its nature is essentially a system which is structured to have current workers pay the benefits of current retirees. That system worked exceptionally well for 50 years in the sense that with the population growing and longevity less than it is today, you had a very large base of workers to finance the number of retirees. But when you get to the demographics which we are confronted with today, that system, as I have indicated elsewhere, is ill-suited to adjust to the future. It can adjust. In other words, you can make a number of adjustments to keep it going and sustaining it, but what is very difficult to do is to create the savings that have to be associated with that process.

The CHAIRMAN. Do you see personal accounts as adding to national savings?

Mr. GREENSPAN. Provided that moving from government savings to private savings, that there are adjustments in government savings. In other words, you need to, whether you are dealing with a lock box for Social Security or private accounts, an adjustment in the on-budget deficit downward, and to the extent that that occurs, you do add to national savings.

The point I have been trying to make in my remarks is that it strikes me that private accounts have a higher probability of achieving that end than the existing Social Security system unless we can find a lock box which works.

The CHAIRMAN. Aren't personal accounts essentially another form of a lock box? I mean, it creates the lock box.

Mr. GREENSPAN. That is another way of looking at it, Senator. In fact, we used to sort of be amused at the notion of a lock box because there is no such obvious vehicle, but it actually was a very thoughtful insight as to what the real problem is, and I think res-

urrecting the notion is something which will facilitate our evaluation not only of private accounts versus Social Security, but all aspects of how one deals with what is going on in the unified budget.

The CHAIRMAN. So if there were one vehicle to create a lock box and it increases national savings, does it also have the benefit of giving to the needy what the rich have, and that is something that grows, compounding interest? In other words, there is a third option to cutting benefits and raising taxes. You can make the money work harder, lock it up, and watch people enjoy the benefit of earnings.

Mr. GREENSPAN. Outside the sheer economics of it, I think there is a value to having individuals who don't have significant wealth at this stage recognize that they have annuities which are really quite valuable. There are differences. Their name isn't put on it. It is not in a lock box, because remember, one of the aspects of the lock box is it has your name on it, and in Chile when they went to this system, they found that a number of people were extraordinarily moved by the fact that they realized that they had far more wealth than they had any notion existed, and I think that is very important in this society, since, as I have commented in a different context, we are confronted with an ever-increasing concentration of income and wealth, and I don't think a democratic society can function well under those conditions. Anything which creates a greater commitment to the society like homeownership or increased wealth, I think is something we should endeavor to move in the direction of, to seek to achieve, and this type of buildup of personal wealth in retirement accounts, even though it is not available for current spending, I do think has real value for society.

The CHAIRMAN. Was the effect in Chile the broadening of the middle class, the shrinking of the gap between rich and poor through personal accounts?

Mr. GREENSPAN. I believe that is the case, but I cautioned earlier that we have to be a little careful about taking examples from other countries which have different circumstances and merely assuming that they are directly applicable to America.

The CHAIRMAN. But they did have to replace a defined benefit system with these personal accounts, I assume.

Mr. GREENSPAN. The general view of the Chilean system is that it has worked well and, indeed, helped finance economic growth in that country.

The CHAIRMAN. The gap between rich and poor has shrunk?

Mr. GREENSPAN. I believe that is correct, but I don't know that is a fact.

The CHAIRMAN. Mr. Chairman, you have been very generous with your time, and you asked us to keep this under 2½ hours, and we have succeeded by 20 minutes. We thank you for not just your time, but your wisdom, and again thank you for your your long service to our country. This hearing is concluded.

[Whereupon, at 12:09 p.m., the committee adjourned.]

APPENDIX

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

April 28, 2005

The Honorable Blanche Lincoln
United States Senate
Washington, D.C. 20510

Dear Senator:

Thank you for the opportunity to respond to your questions. You raised a number of important issues that will have to be addressed as the Congress contemplates changing the Social Security program. As for your question about the retirement age for Social Security, I have consistently supported consideration of increasing the retirement age in light of two developments. First, as you know, life expectancy has increased markedly during the past several decades, and is projected to continue doing so in the decades ahead. For example, an individual turning 65 in 1950 could expect to live almost another 15 years, according to the Social Security Trustees. By 2000, the life expectancy of an individual at age 65 had increased to an additional 18 years. And by 2050, the Trustees project that life expectancy will have increased to another 21 years. A second important development is that the work that Americans perform has become increasingly conceptual in nature. That said, some workers do still work in physically demanding jobs, and any meaningful reform must include a careful consideration of how to structure benefits for those who want to retire early because they are in poor health.

You also asked how workers at the lower end of the income scale would fare under a reform plan that includes private accounts. Answering that question is impossible without reference to a specific plan, but under at least some plans, individuals would not have to come up with new savings to fund individual accounts.

In addition to Social Security reform, the Congress will have to grapple with a wide range of issues in the health area, including, as you noted, the financing of long-term care. Insurance may well play a significant role in financing long-term care for the baby-boom generation, but long-term care insurance is still relatively new and our knowledge about how it will develop is limited; it is also hard to anticipate how other financing arrangements will evolve. What is crucial at present is that the nation starts to address the issue of retirement security. We owe future retirees as much time as possible to adjust their plans for work, saving, and retirement spending. They need to ensure that

their personal resources, along with what they expect to receive from the government, will be sufficient to meet their retirement needs.

Finally, I would emphasize that the issue of retirement adequacy goes beyond the need to shore up Social Security and other programs for the elderly. The fundamental issue is the need for higher national saving. Raising national saving is a reliable and effective way to raise future output. The higher our rate of national saving, the higher our capital stock in the future, the higher is productivity of labor, and the more real goods and services the economy is able to produce. Steps in this direction are the key to ensuring that we will have the capacity in, say, 2030 to produce goods and services adequate to meet the needs of retirees without unduly curbing the standard of living of the working-age population.

Sincerely,

Chairman Greenspan subsequently submitted the following in response to written questions received from Senator James Talent in connection with the March 15, 2005 hearing before the Senate Special Committee on Aging:

1. I am very concerned with the rate that health care costs have increased. Clearly, there is going to be an unprecedented strain on the Medicare and Medicaid to pay for health care as the baby boomers retire.

One concept that I have worked on with Majority Leader Frist is the development of new information technologies for the health care field, which I believe will save the federal government a significant amount of money. Over the last decade, the introduction of information technologies has led to huge gains in productivity across most of the private sector. At the same time, the cost of health care continues to increase at a fast pace and we haven't seen the same productivity gains in this sector.

What's your sense on the best way to apply what we've learned from the private sector to the field of health care?

Addressing the issue of health spending is a daunting task. One important element in health-system reform is likely to be a more thorough harnessing of the capabilities of information technology (IT). Efforts to bring IT into the health system, if supported and promoted, could provide key insights into clinical best practices, substantially increasing the quality of health care while also reducing administrative costs. Furthermore, widespread adoption of electronic medical records would provide a rich data base which could, over time, help determine the best approaches to restraining the growth of overall health-care spending. However, we know little about how rapidly medical technology will continue to advance and little as well about the crucial issue as to whether those innovations will tend to restrain or augment future spending.

2. Mr. Chairman, our nation faces a series of demographic challenges over the next 25 years. By 2030, the baby-boom generation will have largely retired, effectively doubling the size of the age 65 and older population.

One issue that I've heard a lot about back home is how to finance long-term care. Estimates have shown that spending on long-term care alone is expected to reach $346.1 billion by 2040. Currently, 70 percent of long-term care costs are spent on nursing home care, with the average cost at $60,000 per year. Almost 75 percent is publicly funded, with Medicaid covering 58.7 percent and Medicare covering 14.7 percent.

I have seen studies indicating that if more people purchased long-term care insurance, Medicaid's future institutional-care expenses could be reduced by more than $40 billion per year, while providing additional options for seniors, including home care, adult day care, foster care and assisted living. One idea I've been considering is providing an incentive, a tax deduction or a penalty free withdrawal from a retirement account, to purchase long-term care insurance. My sense is that we have to act soon, given that the baby-boom generation will be uninsurable if we wait too long to provide a meaningful incentive to purchase care.

What are your comments on providing an incentive to purchase long-term care?

In thinking about our ability to finance our future commitments, it is important to focus not only on Medicare and Social Security, but on Medicaid as well. Long-term care insurance seems to be a reasonable approach to financing large but uncertain future long-term care needs, and it likely would be socially beneficial if more people purchased it. That said, any additional tax incentives for the purchase of long-term care insurance (long-term care insurance is already excludable from employee income when provided by an employer) would need to be carefully evaluated to ensure that the incentive effects are large enough to be worth the revenue cost. To the extent that tax incentives would primarily reduce the taxes of those already purchasing insurance, the net effect on the economy would be to reduce saving, making it harder, not easier, to meet future long-term care and other commitments.

Chairman Greenspan subsequently submitted the following in response to written questions received from Senator Mel Martinez in connection with the March 15, 2005 hearing before the Senate Special Committee on Aging:

1. Chairman Greenspan, you have already commented on the record that the current financial obligations facing our government through entitlement spending are unsustainable in the future unless something is done now to refine them. In regards to Social Security, do you believe adding a life expectancy component to the Social Security benefit formula is worthy of consideration? Are there any ideas regarding Social Security reform that even at this early date should be removed from consideration?

Improvements in life expectancy have increased the number of years that the typical Social Security beneficiary can expect to receive benefits. In 1950, an individual retiring at 65 could expect to live almost an additional 15 years. In 2000, the comparable person could expect to live an additional 18 years. This trend toward longer life expectancy is projected to continue: The Social Security trustees currently project that, by 2050, an individual retiring at age 65 will have a life expectancy of an additional 21 years. I have testified on several occasions that I believe the Congress should give serious consideration to adjusting benefits to take this development into account.

2. You have come out in support of allowing individuals to set up personal retirement accounts (PRAs) within Social Security. As we in Congress look into how they might work, in your mind, is there any percentage or amount of current payroll taxes that would be a good starting point to allow individuals to begin investing in PRAs? And on that line of thinking, do you think there is an ideal plan of investment options to be offered? Should we make it like the Federal Thrift Savings Plan? What about the idea of increasing the retirement age to help deal with some of the transition cost associated with adding PRAs to Social Security as well as helping to achieve full funding for the program?

As you know from my testimony on March 15, 2005, before the Senate Special Committee on Aging, I support the establishment of personal retirement accounts because of the potential they hold for increasing national saving. A transfer of resources from the Treasury to personal accounts would boost the unified deficit, all else equal; I trust that the Congress would ultimately respond to the higher deficit by cutting spending or raising taxes, thereby raising national saving.

That said, the diversion of payroll taxes to personal accounts should proceed slowly, as it is difficult to gauge how financial markets would react to the higher level of measured deficits. I also believe that the investment options for these accounts should be subject to some restrictions to ensure that individuals do not take on too much risk in their portfolios, particularly as individuals approach retirement. The details of how these objectives would be accomplished would be up to the Congress to determine. Finally, as I noted above, I have consistently supported consideration of increasing the retirement age in light of past and projected improvements in life expectancy.

3. On that same line of thinking, there has been some talk among members that instead of creating PRAs, we should just allow the government to directly invest the trust fund receipts in the market. Can you offer us your opinion on that idea?

I have long been opposed to government ownership of private securities on a large scale, on the grounds that it risks political interference in the allocation of capital--a process that is crucial to the efficient functioning of the economy.

More generally, it is important to recognize that the higher returns associated with equity investment--whether that investment is undertaken individually through PRAs or collectively through the trust fund--reflect the higher risk associated with those investments. Thus, after accounting for risk, investing in private securities does not improve the funding problems of the nation's retirees.

4. What would the impact on the economy be if we increased national savings and investment through personal accounts?

Raising national saving is a reliable and effective way to raise future output. The higher our rate of national saving, the higher our capital stock in the future, the higher is the productivity of labor, and the more real goods and services the economy is able to produce. To the extent that personal accounts could raise national saving by inducing the Congress to adjust to the resulting higher deficits by cutting spending or raising taxes, the introduction of these accounts would increase future output.

5. Can we increase labor market efficiency through personal accounts as workers would see the savings and investment in their accounts as part of their direct compensation rather than a tax?

Ascertaining the labor market effects of personal accounts is difficult. If the diversion of payroll taxes to personal accounts is paired with an offsetting reduction in future Social Security benefits, and if employees understand this, then the introduction of personal accounts would not change the overall return to work. On the other hand, if employees view the payroll tax as a pure tax--rather than viewing it as an investment that yields future Social Security benefits--and if mandatory contributions to personal accounts were perceived as savings, then the introduction of personal accounts could affect the perceived return to work.

6. Would it be fair to say that personal accounts could be designed to give a strong boost to economic growth? If so, could we probably also conclude that workers could get better benefits through personal accounts than they can through Social Security today?

As previously noted, to the extent that a diversion of payroll taxes from the Treasury to personal accounts would induce the Congress to take actions that raise national saving, personal accounts could provide a temporary boost to economic growth and a permanent increase to the level of the productive capacity of the economy. To the extent that individuals invest in private securities, beneficiaries might also expect higher returns on average from personal accounts, but they would also bear greater risk.

7. The CBO projects that under current policies Federal spending as a percent of GDP will soar by 2050 to over 30% compared to 20% today, an increase of over 50%. Can personal accounts help avoid this crisis of runaway big government spending by turning to personal accounts to take over public benefit obligations where they can do a better job of providing benefits to workers?

The potential growth- and budget-related benefits of personal or private accounts stem from the possibility that they might induce the Congress to take measures that raise national saving. If the government simply borrows to fund these accounts, they will not raise the level of real resources available in the future because the increase in personal saving would be offset by greater government borrowing. Unless personal accounts boost national saving, and hence the level of real resources in the future, they will not help alleviate the problems associated with the aging of the population.

8. As a way to help increase national savings as a whole, what would your opinion be on having new employees automatically enrolled in company 401k(s) and then having the option to "opt out" afterwards? Do you feel that this would have a positive impact on national savings?

Research suggests that participation in 401(k) plans is sensitive to the default enrollment policy; when enrollment is automatic, participation often increases substantially, even when workers retain the option to "opt out." To the extent that greater enrollment generates new savings with no offsets elsewhere, national saving would rise.

9. Along those same lines, what about allowing individuals who change jobs and rollover their 401k(s) to be allowed to continue to invest in those accounts instead of how it is currently set up to where they are not allowed to continue to add to those funds once they are rolled over?

Employees who change jobs may roll over balances from their old 401(k) plans and may continue to save for retirement by contributing to their new employer's 401(k) or to IRAs. Employers are currently required to maintain accounts for former employees (provided that the account exceeds a minimum balance), but requiring those employers to continue to accept new contributions from former employees may entail significant administrative expense.